THE NEW YORK

Certified Public Accountant

VOL. XXVI *October* • *1956* No. 10

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Society and Editorial Offices: 677 Fifth Avenue, New York 22, N. Y.

AN ADIRONDACK VIEW

Conservationist is not a word that you can use playing Scrabble or in cross-word puzzles. It is the name of a slick-paper magazine published by the good old State of New York. Perhaps you take it; it is a bi-monthly at $2 per (yes) year.

All the members of this notorious Adirondack Chapter get a subscription with their chapter membership—the same as they also get expenses paid to CPA conferences, Prentice-Hall tax services, U. S. News, a daily paper, an oil painting for the office, a clock, a thermometer, a barometer, etc., etc.

Well, you should read the letters to the Editor in this Conservationist; pages of them and so interesting that the time-to-go-to-sleep comes much too soon. The pictures are beauties, many in color. The articles tell all about animals, birds, fish, lakes, brooks, woods, mountains—our great natural resources.

The final pay-off is provided by Clayt Seagears—an article on the last page illustrated in color on the inside back cover. The August-September issue is about a hummingbird, a catbird, a katydid, and Pa and Ma Spider. It's a humdinger; it makes you rock-an'-roll—mentally.

With this magazine at hand you can spend an evening in the open spaces any time you need to recreate yourself.

LEONARD HOUGHTON, C.P.A.
Saranac Lake Branch
of the "Adirondack Chapter"

Book Reviews

J. K. LASSER'S HANDBOOK OF SUCCESSFUL TAX PROCEDURES *(By J. K. Lasser Tax Institute).*

ELEMENTARY ACCOUNTING *(By Arthur W. Holmes, Gilbert P. Maynard, James Don Edwards, and Robert A. Meier).*

J. K. Lasser's Handbook of Successful Tax Procedures

By J. K. Lasser Tax Institute. SIMON AND SCHUSTER, INC., New York, N. Y., 1956. Pages: x + 276; $4.95.

This handbook covers the field succinctly stated in the last chapter heading "From Tax Return to Tax Court." In a lucid, logical manner, the work outlines the procedures and where appropriate, the alternatives which may be followed in connection with the defense of a tax return as filed.

The first two chapters are an apologia for the Internal Revenue Service. The remainder of the work is concerned with the examination of the return, the rights of protest available to the taxpayer, conferences, time limits, refunds, compromises and appeals. Also covered are the obtaining of the Service's opinions on tax problems, extensions, the availability of the returns for inspection, and the jurisdictions of the various courts handling tax cases. In addition, there is a chapter titled "How the Treasury Catches Tax Cheaters", and one on practice before the Service. Then in the previously mentioned last chapter, a hypothetical case is followed from the filing of the tax return to the filing of the petition in accordance with Rule 7 of Rules of Practice Before the Tax Court of the United States.

The staff of the Institute do what many practitioners haven't the time to do for themselves. They dig into backgrounds and sources and correlate the many appropriate sections of the Internal Revenue Code, the regulations, rulings and decisions, presenting a complete and intelligible picture of the subject which is the hallmark of their work.

FRANK A. DUNN

Iona College
New Rochelle, N. Y.

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SITUATIONS WANTED

(Continued from page 581)

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Book Reviews

(Continued from page 574)

Elementary Accounting

By Arthur W. Holmes, Gilbert P. Maynard, James Don Edwards, and Robert A. Meier. Richard D. Irwin, Inc., Homewood, Illinois, 1956. Pages: xiv + 756; $7.20.

There is a wealth of teachable material in this revised edition of *Elementary Accounting*, originally written by Holmes and Meier in 1949, now by Holmes, Maynard, Edwards and Meier.

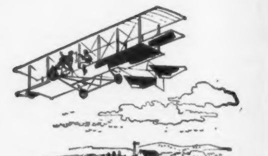
A minor feature that the reviewer likes is the use of an appendix of twenty pages to describe some of the details of withheld income taxes, social security taxes, income and property taxes, etc. Perhaps this feature should be employed more frequently in college accounting texts. The relegation of necessary but secondary descriptive material to appendices is, of course, an indirect way of emphasizing underlying ideas and first considerations. Too often students get lost in the underbrush of petty bookkeeping details during the first weeks of what is supposed to be a course in accounting at the college level. For this the textbook may be partially to blame—particularly if the attempt is made in each chapter to explain all the new points, however trivial, that will be encountered by the student in the problem material at the end of the chapter. A broader use of appendices might help to keep principles distinguished from the mass of detailed information which is essential to the adequate presentation of the subject.

If there is too much detail in this book it is to be found in the early chapters. For example, Chapter 3 on the journalizing and posting processes includes a separate section on each of the following matters:

- Cross-indexing (pp. 42-43)
- Ten advantages of journalizing (p. 44)
- Compound journal entries (pp. 44-45)
- Nine steps in preparing a trial balance (p. 50)
- Ten steps used in locating errors in trial balances (p. 51)
- Forwarding of account totals to the following ledger page (p. 60)

A worthwhile difference from most elementary textbooks is the early presentation of the method by which the cost of merchandise purchased is charged to the asset account—just as the cost of a truck or raw material or almost any other asset would be charged. This is the simple and direct way of handling "purchases" and of illustrating to beginning students the common basis upon which many important costs are first recorded as assets and later are transferred to expense accounts in appropriate amounts. Without burdening the beginning student with the routine of closing out beginning inventory and setting

(Continued on page 579)



Book Reviews

(Continued from page 576)

up ending inventory, the college teacher should be able to explain the flow of cost through the several stages of operations of a manufacturing concern to students at a very early stage in their accounting instruction.

The treachery of definitions is evident in the early parts of the book. Note the following (each is the leading sentence of a section):

> A prepaid expense is a supply or service that has been acquired in one period but not fully consumed in that period; therefore, it is at least partially applicable to subsequent periods. (p. 139)

> An income payment received before it is earned is also called a *deferred credit to income,* or unearned income. (p. 142)

> An accrued expense . . . is an expense that has been incurred on a continuous basis but has not been recorded on the books because the customary time of recognizing the liability has not occurred prior to the end of the period. (p. 146)

> A fixed tangible asset is a relatively permanent equipment asset that remains in the business for a relatively long period of time. (p. 152)

Often the strength or weakness of an elementary textbook is revealed in the chapters on corporate accounts. These chapters are commendable; they contain good illustrations of corporate reporting and many aspects of the accounting for capital stock and retained earnings. Here, if the authors had only gone further in "lifting the veil" of the capital-stock account—by associating this proprietary account more closely with the people investing in or disinvesting from the legal entity called a corporation, rather than having the corporation "sell," "buy," and "resell" its own shares—the real significance of informative annual statements to stockholders and the public, and the accountant's importance in this respect, might have been made more evident to the college student.

An unusually good feature of the book is the excellent coverage of topics in the last ten chapters. Thus, if desired, the college teacher may pass quickly over some of the bookkeeping material of the early chapters in order to take up chapters on any of the following topics: receivables and investments; depreciation and fixed assets; inventories; departmental accounts; branch accounts; manufacturing accounts; income determination; analysis of financial statements.

WENDELL P. TRUMBULL

Associate Professor
New York University

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(Continued from page 580)

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THE NEW YORK
CERTIFIED PUBLIC ACCOUNTANT

EMANUEL SAXE, *Managing Editor*

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VOL. XXVI *October • 1956* No. 10

The President's Page

EMANUEL SAXE

The masthead of *The New York Certified Public Accountant* for March, 1946, contained a new name as Managing Editor—Emanuel Saxe. An editorial in that issue by Benjamin Neuwirth, Chairman of the Editorial Board, explained that Wentworth F. Gantt was retiring as managing editor and Dr. Emanuel Saxe, as the newly appointed Director of Technical Services, had taken over the duties of managing editor.

Dr. Saxe was then a Certified Public Accountant, a member of the Bar, and Associate Professor of Accountancy in the Bernard M. Baruch School of Business and Public Administration of The City College of New York. He had written extensively in the *Journal of Accountancy* and *The New York Certified Public Accountant* and was the author of two definitive texts on Estate Accounting. He entered into his new work with enthusiasm and revitalized the magazine, attracting new and eminent contributing authors, raising the standard of literary excellence, and using a fine sense of discrimination in planning the content. As a result the magazine has become the foremost State Society publication in the country and has received awards for its excellence.

His activity as Director of Technical Services matched the vigor and intelligence which he displayed in his handling of the magazine. His breadth of accounting knowledge and his current acquaintance with it was evident in the section on "Professional Comment" which he conducted for many years. With this background he gave wise guidance to our technical committees over all of the years of his connection with us.

Of course he grew steadily through the years, not only in Society affairs but in service to the community and in his beloved City College. He became Professor in 1948, and Chairman of the Department of Accountancy in 1950. When the post of Dean of the Bernard M. Baruch School of Business and Public Administration became vacant he was the logical choice to fill it. The pressures of this new responsibility have compelled him to relinquish his place as our Director of Technical Services and Managing Editor of our magazine.

The members of the Society are deeply indebted to Dr. Saxe for his great contribution to its growth in stature in the profession. No expression of appreciation would be complete without an acknowledgment of those fine personal qualities—patience, vision, reliability, integrity—which, combined with a warm, friendly and human touch, made us have a great affection for "Mannie". We all wish him well in this new and greater responsibility. Happily, he will still be very much a member of our Society and his counsel and guidance will be available to us.

ARTHUR B. FOYE,
President

L'ENVOI

My ten years of service as Managing Editor of this magazine and Director of Technical Services for the Society have truly been both eventful and exciting. It will not be easy to disassociate myself from this role. I shall always treasure the many friendships which I have been privileged to make.

But I could not have performed as I did without the wonderful cooperation which I received all through these years from the Society's officers, the chairmen and members of the Publication Committees, the technical committees, the general membership, and the office staff. To all these, my profound appreciation and sincere thanks.

E. S.

Should a Corporation Consolidate its Foreign and Domestic Accounts?

By James A. Kelley, C.P.A.

This paper marshals the arguments for and against consolidation of foreign and domestic accounts. It is the author's belief that a conclusive answer, applicable to all situations, is not yet possible, and that each problem must still be solved according to its own peculiar circumstances.

During the past few years, United States corporations engaged in foreign trade, have been concerned with the problem of either consolidating the foreign accounts with the domestic accounts or presenting foreign operations by some other method.

Immediately after the termination of World War II, and for several years thereafter, no such problem existed for the majority of U. S. corporations owning investments abroad. Foreign trade was largely dormant and quite naturally had to take second place to the demands of our domestic economy. Exchange rates were uncertain and often unstable. Exchange restrictions were largely in force between the rest of the world and the United States.

James A. Kelley, C.P.A., is Comptroller of Morey, Humm & Warwick, Inc. (Advertising), New York, N. Y.

Mr. Kelley is a member of our Society and its Committee on Foreign Trade Accounting, the American Institute of Accountants, and the National Association of Cost Accountants.

This paper was presented by Mr. Kelley at a technical meeting of the Society, sponsored by the Committee on Foreign Trade Accounting, held on May 23, 1956, at the Engineering Auditorium in New York City.

In 1956, the situation faced by these corporations and their accountants is quite different. Foreign branches and subsidiary corporations of the U. S. companies are increasingly active. Exchange rates in Europe at least have generally stabilized and exchange restrictions have been eased throughout the world.

And so today, managements of corporations owning foreign investments ask the question, "Should we consolidate the foreign accounts with the domestic accounts?" Our profession must help to answer that question. The answer to the question of foreign-domestic consolidations has two sides, both of which I shall attempt to set forth in this paper.

The foreign-domestic consolidation question isn't easy to answer because the field of foreign trade accounting is a complicated practice. Varieties of puzzling problems may arise in connection with any foreign-domestic consolidation. Standard translation and consolidation procedures followed consistently may yield differing results for separate foreign locations because of varying conditions. There are, however, two fundamental principles that I believe may be agreed upon:

1. There is no stock answer to the translation and consolidation problem. Each problem must be solved in rela-

tion to the circumstances under which the foreign branch or corporation operates.

2. Upon recommending or opposing consolidation of foreign and domestic accounts, we accountants should seek the fairest possible presentation to the reader of the financial statements.

Now, to turn to the specific subject proposed in the paper: "Should a corporation consolidate its foreign and domestic accounts?" Time, of course, will not permit me to present all the positive and negative arguments to the question.

Arguments in Favor of Consolidation

As to the positive side I shall limit myself to four arguments, as follows:

1. If the foreign net assets and results of operations are material in relation to the domestic accounts, we don't have very much of a choice. We should attempt a foreign-domestic consolidation. It follows, therefore, that if we try and are able to consolidate when the foreign net assets and results of operations are material, we should be able to work out a consolidation when they are not material.

2. A foreign-domestic consolidation is the simplest possible method of informing the reader of the total world-wide picture of the corporation. Any other method forces him to add up a set of statements or a domestic statement and a set of footnotes pertaining to foreign operations appended to the domestic statement.

3. A foreign-domestic consolidation removes certain problems which appear when the consolidation is not made, such as the treatment of inter-company transactions. Such transactions must, of course, be eliminated in the world-wide consolidation.

4. We may in the future, if foreign trade becomes more important to the total U. S. economy, be forced to consolidate foreign and domestic accounts. The field of foreign trade may yet tempt American business to undertake the inherent risks involved in investing and trading abroad. At the beginning of May, Mr. H. J. Heinz II, in an address before the American Management Association, stated that in 1955, American business invested only $1,600,000 abroad, whereas the dividends and profit remittances from foreign investments ran to $2,200,000. Here is a field of enterprise in which the take-home ran higher than the annual investment input. If our economy in its desire to open up new markets for investment and consumption expands into the foreign field, then we may have to consolidate those investments and those operations. Why, therefore, not do so now and lay the foundations to meet this possible future necessity?

Arguments Against Consolidation

So much for the positive side of the answer to the question of foreign-domestic consolidations. The negative arguments against such consolidations that I can think of run to three in number and are as follows:

1. If the foreign net assets and operations are not material in relation to the domestic accounts, why undertake the strain of making a fair consolidation? When we translate foreign accounts we are, after all, estimating dollars. Hindsight may prove that our estimates were subject to pressures by forces which could not be foreseen at the financial statement date. If the estimates are not material, why not place them amongst the footnotes to the financial statements where all estimates indeterminate as to amount truly belong?

2. If the foreign net assets and operations are not material in relation to the domestic accounts, why must we attempt to give the reader of the financial statements a total world-wide picture. We may find ourselves in the position of being able to consolidate certain locations, but unable to consolidate others because of such conditions as unstable currencies or complete exchange blockage. If we then consolidate only certain of the locations, the reader must still digest a footnote as to the unconsolidated locations.

3. Generally accepted procedures for translating foreign financial statements often either produce strange results or are inconclusive. As to the first point—the production of strange results—consider the generally accepted procedure of translating the property, plant and equipment accounts at "historical dollar costs." First of all, we must determine what historical dollar costs are and many perplexing questions arise on that subject. And even after determining historical dollar costs we may yet be confounded.

Consider this actual case history: A Latin-American branch reported an accumulated local currency deficit in its year-end balance sheet. Broken down to component parts, the local currency working capital deficit exceeded the local currency net fixed assets. The fixed assets had, however, been acquired over a long period of time and at substantially higher exchange rates than the current rate used to translate the working capital deficit. After translating the net fixed assets at historical rates, the dollar statement presented a surplus. Historical dollars had played the strange trick of converting a local currency deficit into a dollar surplus, a result impossible and completely contradictory to straight dollar accounting. Perhaps we had better take another look at this method of translating property, plant and equipment.

We often find our generally accepted procedure inconclusive in a foreign-domestic consolidation because of our inability to state the foreign net assets so consolidated which are available for dividend and profit remittance distribution by reason of indeterminate foreign taxation, laws and customs. We warn the reader of the statements of these restrictions by a general footnote. But we don't attempt to give amounts. Surely with the help of our friends—the foreign tax experts, the lawyers, and the economists—we can come up with some sort of an estimate; but until we can explore the feasibility of making such estimates we should not attempt to mix foreign and domestic net assets.

This paper has set forth certain arguments, pro and con, of the foreign-domestic consolidation question without attempting to supply a conclusive answer. I do not think a conclusive answer is possible at this time because the field of foreign trade accounting has too long been dormant in our profession. That has been too bad, for foreign trade accounting is filled with those fascinatingly complex problems which delight and stimulate the accounting intellect.

It is my sincere hope that in the very near future our profession will commence the research and exchange of ideas that will enable us to decide whether we should consolidate foreign and domestic accounts. We may even be able to come up with standardized answers, but I hope not. There wouldn't be any fun in foreign trade accounting if we did.

Selecting the Appropriate Exchange Rate for the Translation of Foreign Subsidiary (or Branch) Accounts into U.S. Dollars

By GRAYDON L. LONSFORD, C.P.A.

This paper discusses some of the problems encountered in selecting the appropriate exchange rate for translating foreign currency accounts into U. S. dollars (a) when there is a free flow of exchange and (b) when multiple exchange rates are in effect, or when dollars are temporarily unavailable.

The American Institute research bulletin on Foreign Operations and Foreign Exchange is a masterly resumé of the broad principles of foreign exchange procedures. To me it is remarkable that the bulletin was adopted with only two members of the committee making qualifications. I have the feeling that, at the outset, there were many differences of opinion. It is an extremely controversial subject—and the practical problems arising in the application of these broad principles, are probably even more controversial.

Free Flow of Exchange—Single Rate

I have been asked to discuss the problem of selecting the appropriate type of exchange rate to be used for the translation of the local currency accounts of a foreign subsidiary (or branch) into U. S. dollars. Where there is a free flow of exchange, and where only one exchange rate is involved, the problem is simple. Exchange rates are quoted in publications or may be obtained from banks. In such cases, the local (foreign) bank selling rate for dollars, or to put it another way, the rate at which the foreign subsidiary or branch can buy dollars for remittance to the parent or home office, is the rate to be used. Usually, this rate is exclusive of any bank charges which might be incurred for such remittance. These charges are merely expensed when incurred.

GRAYDON L. LONSFORD, C.P.A., a member of our Society and of the American Institute of Accountants, is now serving on our Foreign Trade Accounting Committee. Mr. Lonsford is with the Standard Oil Company (New Jersey).

This paper was presented by Mr. Lonsford at a technical meeting of the Society held on May 23, 1956, under the auspices of the Committee on Foreign Trade Accounting, at the Engineering Societies Building in New York City.

Multiple Exchange Rates

In some countries, particularly in Latin America, multiple exchange rates constitute a part of the exchange control system. For example, dollars required for the importation of various essential products may be obtained at more favorable exchange rates than the rate at which dollars may be obtained for profit or dividend remittances (Brazil, for example). The selection of the appropriate and most realistic exchange rate for the translation of the

local currency accounts into U. S. dollars, where such multiple exchange rates are in effect is of paramount importance.

For transactions involving dollars, the actual dollar amounts and the local currency required to obtain such dollars would be used. The problem then, is confined to the selection of the type of exchange rate to be used for the normal conversion procedure applicable to local currency accounts which are converted to dollars at "prevailing," "average" or "year-end" exchange rates. In the absence of a free rate, the logical rate for this purpose would appear to be the most realistic one applicable to profit or dividend remittances.

Specific Example—Chile

The problem of selecting the appropriate and most realistic exchange rate to be used, where the exchange control involves multiple rates might best be explored by taking a specific country. Chile, prior to the recent change in its exchange system, is an interesting example. Let us consider it from the standpoint of a U. S.-owned subsidiary operating in Chile, prior to April 20, 1956.

Exchange controls, in some form, had been in operation in Chile since 1931. Extreme internal inflation and an unfavorable balance of payments had resulted in successive devaluations of the peso and a continuation of exchange controls. These controls were based on a combination of multiple exchange rates and quantitative restrictions. Special treatment was accorded investors in copper and nitrate industries, which had agreements involving profit remittances and the repatriation of capital. However, these industries exported to the United States and received payments in dollars. Part of these dollars were not required to be repatriated and were therefore available for dividend and other dollar payments. Also, new investments approved by the Government, were subject to contractual arrangements between the investor and the Chilean Government, for the remittance of profits and for the gradual repatriation of capital after five years, both at prevailing official exchange rates.

Non-approved investments had to apply for a license to exchange pesos for dollars at the official rate.

In any case, the securing of dollars was dependent upon their availability, and since available dollars were being used to pay off a backlog of indebtedness and the liability for current imports, practically none were available for profit remittances.

In addition, there was a trading in exchange by individuals in the "Casa de Cambio" (exchange houses), principally involving dollar salary checks and tourists' dollars. This exchange rate was considerably lower than the official rate. This was not only a thin market, but dollars so obtained could not be used for business purposes.

Under the above circumstances the official exchange rate applicable to profit remittances appeared to be the logical choice for the translation of peso financial results into terms of dollars. On April 20, 1956, the Chilean Government made a further devaluation of the peso, but discontinued the use of multiple exchange rates. The new "free market" rate is about 500 pesos to the dollar. At this time, the Chilean Government is not making dollars available, and the picture is not yet clear. However, largely because of a strengthened worldwide demand for copper, there has been a marked improvement in the Chilean balance of payments in

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Taxation of Income from Foreign Sources Subject to Blocked Currency Restrictions

By David Shechet, C.P.A.

This paper explains the methods prescribed by the Treasury Department for the deferment of income tax on income represented by blocked foreign currency, as well as for the reporting of such previously deferred income when the currency restrictions have been removed. The author favors the use of such election to defer.

On May 23, 1956, agreements were signed concluding the fourth World Tariff conference held since World War II. These agreements further slashed customs duties on some two billions of dollars of annual trade carried on between the various signing countries including the United States. It is anticipated that these gradual tariff reductions will increase foreign trade by various United States taxpayers.

Along with this increase in foreign trade we can expect to find a greater number of United States businessmen concerned with blocked foreign currency and its treatment for domestic tax purposes.

Treasury Rules for Deferment of Tax on Income Represented by Blocked Foreign Currency

The Treasury Department recognized this problem of blocked foreign currency and in March, 1950, issued Mim. 6475 (as amended in the same month by Mim. 6494) setting forth the rules under which the tax on such income can be deferred, the procedure to be followed upon deferment, and the method to be followed when such income is finally to be reported. My position is that a taxpayer should avail himself of his right to defer in almost every case other than the very exceptional ones.

The right to defer is available to all resident taxpayers be they corporate, individuals or partnerships. The rule states that blocked income is income in a foreign currency which, because of foreign monetary or exchange restrictions, cannot be readily convertible into United States dollars or into property which can be readily convertible into United States dollars. It ceases to be blocked, and hence deferable, when either of the previously mentioned two conditions ceases to exist or in any of the following circumstances:

1. It is used for non-deductible personal expenses (such as using French francs to attend the wedding of Grace Kelly).

2. Such income is disposed of by way of gift, bequest, devise or inheritance.

3. Such income is disposed of by some dividend or other distribution.

David Shechet, C.P.A. is a partner in the firm of Shechet & Shechet, Certified Public Accountants.

He is a member of our Society since 1944 and has had extensive experience in the field of Foreign Trade and Taxation.

This paper was presented by him at a technical meeting of the Society's Committee on Foreign Trade Accounting held on May 23, 1956.

4. In the case of a resident alien, should he terminate his residence in the United States.

Any act involving any of these four circumstances will result in the immediate recognition as taxable income of the entire amount so used or disposed of. The desirability of a voluntary act of this kind must therefore be carefully measured against its tax implications before completing it.

Procedure in Reporting Deferable Foreign Income

As to the procedure involved in availing oneself of the right to defer blocked foreign income, a taxpayer must indicate such choice by filing with his regular tax return an added return showing such added blocked income but computing no tax thereon. This return is headed "Report of Deferable Foreign Income Pursuant to Mim. 6475". With such return the taxpayer must file a statement wherein he declares that such blocked income will be included in his tax return when it ceases to be deferable. He also states that he will not claim in the future that the income shown as deferred on this tax return was reported as income in some prior year. Furthermore, once the taxpayer makes the choice of deferring blocked income until it is convertible, he must continue to report on this basis in subsequent years. He can only change his method upon securing the consent of the Commissioner, which will rarely be given unless there is very good justification from the viewpoint of the United States government.

Method of Reporting Deferred Income When Unblocked

As to the method to be used in reporting such income when it becomes unblocked, under the deferred method of reporting, one must keep in mind several rules:

1. Expenses paid or incurred in a foreign currency can only be deducted proportionately against the blocked foreign gross income earned in the particular year when the expenses were paid or incurred. For example, $15,000 spent in Italian lire for various promotional costs resulting in the production of $30,000 of gross blocked income can only be deducted at some future time when any of the $30,000 becomes unblocked, and then to the extent of 50% of the amount that is unblocked.

2. Costs and expenses paid out in United States dollars in connection with the production of foreign blocked income may not be deducted against other United States income so long as there still is deferred income which has not been reported.

A distinction in the method of offsetting costs of inventory paid in United States dollars as against direct expenses, such as promotional costs, paid in United States dollars is also made. Unrecovered inventory costs may be offset against foreign income even if they represent the cost of more units than are being reported for sales purposes, so long as they do not exceed the amount of United States dollars being reported from such foreign source. For example, assume that ten tractors are exported at a domestic cost of $1,000 per tractor (total—$10,000) and six tractors are sold in a foreign country for $2,500 each (total—$15,000) of which $12,000 is freed for United States dollars. In this case the entire $10,000 United States cost of all ten tractors may be offset against the $12,000 to be included as gross foreign income. On the other hand, direct expenses such as catalogues may only be

offset in an amount proportionate to the gross proceeds being included in income.

Advantages of Deferring the Tax

The two great advantages of deferring the tax on blocked income are:

1. It conserves cash and therefore does not represent a further drain on United States dollars.

2. The tax is paid on actual United States dollars available, and eliminates the need to know the rate to be used in converting the blocked foreign income.

By knowing the actual dollar amount to be received, the taxpayer avoids paying tax on a foreign income only to find at some future time that fluctuation in the currency rate has wiped out most of the income he thought he earned and hence paid tax on.

I have known taxpayers who have felt that so long as they could legally defer payment of taxes and use the cash so made available to them for further ventures, they would in due time earn enough in these ventures to offset any possible increased taxes that might arise in the future as a result of their decision to defer.

Conclusion

I therefore conclude that unless some very definite immediate advantages in not deferring are apparent, the right to defer blocked foreign income is a valuable one and should be availed of by most taxpayers.

Selecting the Appropriate Exchange Rate for the Translation of Foreign Subsidiary (or Branch) Accounts into U. S. Dollars

(Continued from page 589)

the last year — accompanied by increased holdings of gold and foreign exchange and a reduction in commercial arrears. Consequently, it is expected that dollars will be made available for all purposes, in the near future.

At the present time, then, the rate to be used for the translation of Chilean peso accounts into dollars, is the quoted "free market" rate.

Summary

I have tried to convey a feeling of the objective and some of the problems encountered in selecting the appropriate exchange rate for translating foreign currency accounts into U. S. dollars, on the assumption that dollar equivalents are required. In principle, where there is a free flow of exchange, the dollar value of a transaction is the same, whether it originates in local currency and is translated into dollars at the prevailing exchange rate, or actual dollars are involved. Where dollar exchange is temporarily unavailable, the best estimate available would seem to be the quoted rate for profit or dividend remittances. Where multiple exchange rates are in effect, the exchange rate applicable to profit or dividend remittances would also appear the most logical one to use.

Taxation of Income from Foreign Sources Subject to Blocked Currency Restrictions

By CARL WEIL, C.P.A.

This paper advances many reasons which lead its author to conclude, contrary to the view expressed in the previous paper by Mr. Shechet, that it is *not* advisable to defer.

A few days ago The New York Times published an article entitled "Federal Tax Policy Termed Deterrent to Expansion of U. S. Business Abroad." The article mentioned that total foreign sales of American companies had reached the total of fifty billion dollars annually. From this report you may see the importance of discussing problems in connection with income from abroad.

Since World War I, foreign operations have been influenced to a great degree by devaluation of currency and currency restrictions. Even now, some foreign countries have several different rates of exchange for their currency. Among other designations these rates are known as: the official rate, the free rate, the export rate, and/or the rate for blocked currency.

The American Institute of Accountants was well aware of the difficulty of translating into U. S. currency the current assets and liabilities, and the income or loss reflected in the financial statements of companies which have branches or subsidiaries in foreign countries which do not permit an unrestricted transfer of foreign currency into U. S. dollars. However, its bulletin, "Treatment of earnings and assets of branches in foreign countries", does not deal with this subject from the point of view of the income tax.

The Treasury Department has perceived the difficulties in translating income earned in foreign countries into U. S. dollars in such cases where a transfer of the income to the U. S. is blocked. My colleague, Mr. Shechet, has already elaborated on the ruling on this subject issued by the U S. Treasury. In addition to his remarks, I want to reiterate that once the taxpayer has elected to defer, he has to stick to that method. If he defers, he has to defer the reporting of his income from *all* countries in which he has blocked income.

The question arises: What is more advisable—To defer or not to defer? For the following reasons, I am of the opinion that in most cases the taxpayer is better off by *not* deferring:

1. If taxpayer elects to defer, he will accumulate the income of several years. It then might happen—and very often does—that suddenly all blocked income ceases to be deferred. This may bring

CARL WEIL, C.P.A., is a member of the Society and its Committee on Foreign Trade Accounting. He is also a member of the American Institute of Acountants. Until 1938 he was a *Wirtschaftspruefer* in Germany.

This paper was presented by Mr. Weil at a technical meeting of the Society held on May 23rd, 1956, under the auspices of the Committee on Foreign Trade Accounting, at the Engineering Societies Building in New York City.

the taxpayer into a high income tax bracket. Such accumulation of income may occur in case of the death of the taxpayer, or in the case the foreign currency suddenly ceases to be blocked.

2. The Regulations provide that the foreign tax credit may be taken only in that year in which the taxable income is reported. In many cases income received in one year in the foreign country ceases to be deferred only after the passage of several years. It will then be difficult to allocate the foreign tax credit to the particular income which has to be reported as taxable in the United States.

3. The Regulations provide that expenses paid in connection with blocked income in foreign countries may only be deducted in the year in which this income is reported as taxable. It is often difficult to allocate these expenses over several years.

4. *Not* deferring might result in tax savings, since the taxpayer may have the right to report capital gain instead of ordinary income. Consider the following example: Taxpayer has income from rent in foreign countries in the year 1954, which makes him the owner of foreign currency. If he is able to transfer this foreign currency after six months at a higher exchange rate than reported, he has a capital gain instead of ordinary income.

5. Besides, the Mimeograph in question prescribes regulations concerning income from sale of merchandise. In cases where you elect to defer, a separate bookkeeping system would be necessary in order to comply with these regulations. You may have to give proof to the Treasury Department that all income which you deferred was subsequently reported as taxable income. You may have to give evidence that you reported the income in the year in which it ceased to be deferable, and that the tax credit for foreign income taxes was allocated to the corresponding year.

6. Finally, may I draw the attention of those taxpayers who do not defer and who are not in a position to pay their taxes in U. S. dollars, to Section 6316 of the 1954 Code, which reads as follows:

> "The Secretary or his Delegate is authorized in his discretion to allow payment of taxes in the currency of a foreign country under such circumstances and subject to such conditions as the Secretary or his Delegate may by regulations prescribe."

Considering the foregoing reasons, it is my conclusion, that it is *not* advisable to defer.

Franchise Tax Savings Opportunities

By J. R. Gough, C.P.A.

After outlining the general framework of the New York State Franchise Tax on business corporations, the author makes several suggestions for minimizing the impact of this levy.

The significant part of the title of this discussion is franchise tax savings. The State of New York's regulations 9-A, which govern the taxation of business corporations, will not be explained in detail because the regulations can be obtained from the Corporation Tax Bureau and read at leisure. Some areas will be pointed out where thinking and planning can be done to minimize New York State franchise tax on business corporations.

While searching around for franchise tax savings ideas, I asked one of our colleagues if he had a good way to save New York State franchise tax. He replied, "Merely stay out of New York State". Staying out of New York State, being in most cases impracticable, I will not discuss this possibility further, although in some cases it may solve New York tax problems.

J. R. Gough, C.P.A., is a Tax Manager in the New York office of Arthur Young & Company. He holds B.A. and M.B.A. degrees, and has taught Taxation at Hofstra College. He is a member of the American Institute of Accountants and of the Society, where he has served on the State Taxation Committee. He has also served as Chairman of the Taxation Committee of the Nassau-Suffolk chapter.

This paper was presented by Mr. Gough at a Technical Meeting of the Society held on April 9, 1956, under the auspices of the Committee on New York State Taxation, at the Engineering Societies Building in New York City.

Framework of Tax on Business Corporations

The tax may be levied on either capital or on income. Before the base of the tax is arrived at, both capital and income are broken up into various segments, namely, that relating to business, that relating to investments, and that relating to subsidiaries. These various segments are then allocated into two portions (a) that falling within New York State and (b) the other designated as without New York State. These various split-ups and allocations are necessary in order to provide a fair basis of taxation, so as not to drive corporate taxpayers out of New York State.

Business income and business capital is merely the residue after subtracting from total capital and income, investment and subsidiary capital and income. For the average business corporation, the tax on business income is the tax which is the highest and is, therefore, the basis on which the tax is usually paid.

Business income is apportioned within and without New York State by use of an allocation formula which is an average of 3 percentages. The 3 percentages represent ratios of wages within the state to total wages, assets employed within the state to total assets, and gross receipts within the state to total gross receipts. New York State franchise tax

on business income will be minimized when these ratios and the resulting allocation percentage are reduced as low as possible.

Establish a Regular Place of Business Outside New York State

Before a business corporation is entitled to allocate a portion of its business income without the state, the corporation must maintain a regular place of business outside of New York State. A regular place of business is any bona-fide office, factory, warehouse, or other place of business which is regularly used by the taxpayer in carrying on its business. For example, a public warehouse used by the taxpayer would be a regular place of business and entitle the taxpayer to allocate part of its business income without the state. In some cases, the mere establishment of a regular place of business outside the state may produce material franchise tax savings. For instance, a trading corporation with its only office in New York State, which buys and resells largely without the state, may have no regular place of business without the state, in which case it would pay the full New York State franchise tax on its business income. However, if this trading corporation should establish a regular place of business outside of New York State, the franchise tax probably would be materially reduced because the taxpayer would then be permitted to apply the allocation formula and may find that a large portion of its sales, property, and wages are allocable outside the state.

Allocate Gross Receipts Out of New York State

In order to allocate a sale without New York State for purposes of the allocation formula, the property sold either must be located at a permanent and continuous place of business outside of New York, or the property must be located outside of New York State when appropriated to the order and the order must be accepted out of New York State. Under the regulations, an order is accepted where the contract becomes binding.

A permanent and continuous place of business is different from a regular place of business which is necessary before any allocation can be made. If a regular place of business has an employee of the taxpayer regularly in attendance, the regular place of business also becomes a permanent and continuous place of business. As I just mentioned, a taxpayer is entitled to allocate any deliveries from a permanent and continuous place of business located outside of New York State, and they are not considered as New York State sales. Therefore, it follows that on a given set of facts it may be possible to place a bona-fide employee at what would otherwise not qualify as a permanent and continuous place of business, thereby permitting the allocation of sales outside of New York State and thus reducing the gross receipts factor in the allocation formula with consequent saving in New York State franchise tax.

In the event that it is impracticable to have an employee at a regular place of business, for instance, at a public warehouse, it is still possible to allocate sales outside of New York State if the order is accepted outside of New York State. It may be possible to delegate to outside salesmen authority to accept specific orders outside New York State with a view toward minimizing New York State franchise tax.

Effect on Other States

Before various factual changes are made to reduce New York State franchise tax, it is obvious that the effect on other state franchise or income taxes

must be considered, but since the various states usually have different rules for allocation, it is necessary to consider each set of facts separately and no general rule can be set down. For instance, if a taxpayer should have its plant and warehouse in Connecticut, but its sales office in New York where orders are accepted, it is likely that sales will be allocated neither to Connecticut nor to New York because of the difference in definition of both states in how a sale is to be allocated. If these facts were reversed, that is, the taxpayer had its plant and warehouse in New York with its sales office where orders are accepted in Connecticut, sales would be fully allocated to both jurisdictions.

Equitable Adjustment

At this point, it is well to mention that New York State rules provide for an equitable adjustment where the allocation formula does not produce a reasonable result. Although the equitable adjustment provisions of the regulations are very sparingly applied, it may be worthwhile to present hardship cases with suggested solutions to the Corporation Tax Bureau for relief. It may also be well to mention that New York State does not permit separate accounting; the allocation rules must be used.

Use the Investment Allocation

The investment allocation can only operate to reduce New York State franchise tax and it is not necessary to have any regular place of business outside of New York State in order to make the investment allocation. It is merely necessary that the taxpayer have an investment in stocks or bonds or other corporate securities.

The investment allocation is made by obtaining from the Corporation Tax Bureau of the State Tax Commission appropriate allocation percentages for each corporate security owned. These percentages are applied to the value of the corporate securities and an over-all investment allocation percentage arrived at, which is then used to allocate both investment income and investment capital within and without the state. When the investment allocation percentages are received from the Corporation Tax Bureau, it is frequently beneficial to review them, since it has been my experience that clerical errors are frequently made and you will find that occasionally a corporate security which obviously should be allocated largely without New York State will be largely allocated within New York State by the Corporation Tax Bureau. The Corporation Tax Bureau will correct these errors.

Acquire Outside Corporate Investment for Tax Purposes

If a taxpayer does not have any corporate investments, income from U. S. bonds is taxable as business income and the bonds themselves are taxable as business capital. However, if a taxpayer has corporate investments, the investment allocation percentage may be applied to both U. S. bond interest, U. S. bonds, and cash. Although there is a 15% floor on the allocation of investment capital, there is no such floor on the allocation of investment income. It is, therefore, possible that a modest investment in a corporate security outside New York State, for instance, Pacific Gas and Electric common stock, may result in a material amount of U. S. bond interest escaping the 5½% tax on income. In the event that the tax is to be based on capital, the cash and government security allocation may be reduced to 15%, because of minor corporate investments allocated without the State of New York.

Interest Income from Subsidiaries

Switching to the tax on subsidiaries, one point should be considered. New York State does not tax income from subsidiary capital, but a small tax is levied on the subsidiary capital itself.

In the case of loans to a subsidiary, the loan in the hands of the parent will be considered subsidiary capital only if the subsidiary itself does not claim an interest deduction on its franchise tax return in New York State. In other words, the parent corporation will not be taxed on interest received from its subsidiary unless the subsidiary takes a deduction for the interest. However, since the interest deduction permitted the subsidiary is limited by statute and since for other reasons it may not produce full tax advantage, in many cases it will be profitable, franchise tax-wise, for the subsidiary not to claim an interest deduction so that the interest income will not be taxable to its parent.

Tax on Officers' Compensation

As an alternative to the regular tax on income, if the tax is higher, New York State levies a tax on the so-called officers' compensation method, which I will not describe since the instructions to Form 3-CT do so. However, it should be borne in mind that the number of general officers of a corporation is under the control of the corporation itself and frequently New York State franchise tax will be saved if a corporation has fewer elected or appointed officers. The possibilities for tax savings in this area are probably most relevant to closely-held family corporations.

Combined Reports

Another possibility which may produce tax savings in some areas is the filing of a combined New York State franchise tax report. In order to file a combined New York State report, a showing has to be made to the state that the combined report is more equitable and clearly reflects a unitary business conducted through several corporations. Once a combined report is filed, permission must be obtained before separate reports can again be filed. The only over-all income adjustment resulting from the filing of a combined report is the elimination of dividend income, which, being subsidiary income, is not taxed anyway. Tax saving may result through reducing profits by losses or through the over-all effect on the allocation factors. In some cases the effect on these allocation factors can be dramatic and the possibility of a combined report must be considered. It should also be mentioned that in some cases New York State can insist upon the filing of a combined report, which may not always be to the taxpayer's advantage.

Settlements with Corporation Tax Bureau

The Corporation Tax Bureau is fair and reasonable to deal with, and the Bureau also makes many settlements that are not published in ruling form. Because New York State Regulations 9-A define income as that reported to the federal authorities, with certain statutory exceptions, possibilities of inequities develop. For instance, if a consolidated federal income tax return is filed, later followed by separate federal returns, the federal consolidated regulations require possible adverse adjustments to inventories and the basis of assets. If separate New York State reports have been filed during the consolidated federal period, it would be inequitable for New York State to require that the same adjustments be made to New York State income during the separate federal return year. However, since these federal adjustments are not among the exceptions permitted by Regulations 9-A, double taxation by New York State may result.

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What's New in New York State Income Taxation

By Philip D. Brent, C.P.A.

This article reviews some of the latest changes and modifications with respect to personal income and franchise tax laws of New York State.

The most significant news in the field of state income taxation was the recent enactment of four amendments to the Tax Law, signed by Governor Harriman on April 6, 1956. The first of these grants taxpayers a percentage reduction and credit against their capital gain and normal tax for any tax year ending on December 31, 1955, or during the calendar year 1956. This bill is expected to reduce tax levies about $40,000,000. A further tax revenue reduction of about $10,000,000 is an expected result of what is known as the three "humanizing bills", which provide benefits for some of the aged, blind, sick, as well as working widows and widowers.

Credit Against Normal Tax and Net Capital Gain

Taxpayers are allowed a credit against their total normal tax and net capital gain tax of 15% on the first $100 of such tax plus 10% of the next $200 of such tax or any smaller balance. The maximum credit is therefore $35. The credit does not apply to the unincorporated business tax. For example, if the taxpayer's normal tax is $30, his net capital gain tax is $200, and his unincorporated business tax is $100, then the total or gross tax is $330; however, the tax credit is $28 and the balance or tax due is $302. If taxpayer's normal tax is $200, and his capital gain tax is $140, the credit is the $35 maximum allowable and the balance of tax due would be $305. Married taxpayers filing separate returns are each entitled to a credit.

Philip D. Brent, C.P.A. and member of the New York Bar, is a member of the Society and of its Committee on State Taxation. He is also a member of the American Institute of Accountants. He is a lecturer on income taxation at the Bernard M. Baruch School of Business and Public Administration of The City College of New York. Mr. Brent is a partner in B. Waltzer & Co., CPAs.

This paper is based upon an address delivered by Mr. Brent before the technical meeting of the Society held on April 9, 1956, under the auspices of the Committee on State Taxation.

Increased Medical Expense Deductions

This provision (amending Sec. 360, subd. 15 of the Tax Law) adds the following substantive changes to the medical deduction allowance:

(a) Taxpayers may deduct all medical expenses in excess of 3% of net income (computed without benefit of the medical deduction) which do not exceed $6,000 plus 5% of such net income in excess of $6,000. Thus, the exclusion or non-deductible portion of the medical expenses for a taxpayer with a $2,000 net income would be $60; on $6,000 — $180; on $7,000 — $230; and on $50,000—$2,380. Heretofore the exclusion was a straight 5% of net income computed before deducting the medical deduction.

(b) The undiminished total amount of medical expenses for a taxpayer, his

spouse or a dependent may be deducted on a joint return where either spouse has attained the age of sixty-five or is blind, *and* on an individual (which term encompasses a head-of-family taxpayer) return where such individual has attained the age of sixty-five or is blind.

(c) The maximum deduction for medical expenses for any taxable year has been increased, as follows:

Joint return by husband and wife	$2,500
Head-of-family return .	2,500
Individual return	1,250

Previously the respective limitations had been $1,500 in the case of joint and head-of-family returns, and $750 on individual returns.

(d) Transportation primarily for and essential to medical care may now be deducted. Although the Federal Bureau of Internal Revenue has expressly construed such transportation expenses as deductible medical expenses, the deductibility of this item for state income tax purposes has heretofore been dubious.

These new rules apply to taxable years commencing on or after January 1, 1956.

Additional Exemptions for Aged and Blind

A new additional exemption of $400 is granted to taxpayers who are 65 years of age or more, or who are blind. (Tax Law, Sec. 362, new §§, 2A, 2B and 2C). If both 65 and blind, two such exemptions are allowable. Where a husband and wife file a joint return and both are 65 or over, the total exemption is $800. Likewise, if both husband and wife are blind. However, if the *gross* income of the taxpayer, or the aggregate gross income of a husband and wife living together, exceeds $6,000, these old age and blindness exemptions are reduced by the amount of such excess gross income.

These exemptions may be divided between husband and wife, if separate returns are filed, just as the marital exemption of $2,500 may be divided between the spouses. Thus, a husband and wife both of whom are over 65 and blind, and whose aggregate gross income does not exceed $6,000 are allowed total exemptions of $4,100, which may be divided as they wish on separate returns.

An individual is considered as blind for purposes of this new section of the tax law only if his central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or if his visual acuity is greater than 20/200, but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual fields subtends an angle no greater than 20 degrees.

These new rules apply to taxable years commencing on or after January 1, 1956.

Dependent Care Expense Deduction

The third of the humanizing bills allows deductions for expenses incurred in the care of certain dependents, so as to enable certain taxpayers to be gainfully employed. (Tax Law, Sec. 360, new subd. 25.)

A—*Taxpayers who qualify for this deduction:*

1. Single women.
2. A married woman filing a joint return with her husband for the taxable year. A woman shall be considered single, and not as married, if she is legally separated from her spouse under a decree of divorce or of separate maintenance
3. Widowers.
4. Men legally separated under a decree of divorce or separate maintenance.

B—*Type of Care Expenses Allowable for this Deduction:*

Generally, a taxpayer is entitled to an exemption of not more than $400 for each dependent, the term dependent being defined as one—

(a) receiving his chief financial support from taxpayer

and (b) who is 18 years of age or under, or mentally or physically incapable of self-support, or a full time student (relation and legal obligation to support are not requisites).

Only care-expenses necessary so that the taxpayer can be gainfully employed, and which are paid or incurred during the taxable year for certain classes of dependents, are deductible. This person must not only otherwise qualify within the general definition of the term dependent but must also—

(1) be under 12 years of age and a son, stepson, daughter or stepdaughter of the taxpayer,

or (2) be physically or mentally incapable of caring for himself.

C—Limitations:

1. Amounts paid to an individual who is dependent upon and receiving his chief support from the taxpayer is not an allowable deduction to payor. (*Example:* Taxpayer pays dependent aged mother to care for infant dependent daughter.)

2. Maximum allowable deduction is $400 for any one qualifying dependent, and $800 for all qualifying dependents.

3. The total deduction is further reduced by the amount, if any, by which the gross income of the taxpayer and his spouse shall exceed $6,000. (*Example:* During the year 1956, a mother pays nursery $800 for the care of her only child (age 5) so that she may be gainfully employed. The gross income on joint return of taxpayer and spouse is $6,300. The maximum deduction is $400, which must be reduced to the extent gross income exceeds $6,000. The allowable deduction is, therefore $100.)

This provision applies to returns for taxable years commencing on or after January 1, 1956.

Statute of Limitations for Revision or Refund of Personal Income Tax

Previously the two-year limitation period on applications for revision or refund of personal income tax commenced when the return was filed, regardless of whether the tax payment was made earlier. The law now provides that the statutory period starts running from the time the tax is paid or the return filed, whichever is earlier. This section provides that a return filed or a tax paid before the last day prescribed for filing shall be considered as filed or paid on such last day. This modification of Tax Law, Sec. 374, applies to returns for any taxable year commencing on or after January 1, 1955.

Payments Under Written Separation Agreements

Previously periodic alimony payments, to be deductible by the husband and taxable to the wife, had to be made under or pursuant to a court decree of divorce or separate maintenance. Hereafter this rule (Tax Law, Sec. 359-8, as amended) applies—

(a) even if the decree only requires payment for support and maintenance,

or (b) if a wife is separated from her husband pursuant to a written executed agreement, regardless of the presence of a court decree. Periodic payments, whether or not made at regular intervals, and received after the agreement is executed, are includible in the wife's gross in-

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New York State Income Tax Problems Relating to Decedents, Estates and Trusts

By Abraham J. Briloff, C.P.A.

Some special situations, which may present difficulty to the unwary practitioner, are discussed by the author in this paper.

All too often some practitioners are inclined to prepare state tax returns pragmatically and empirically. Thus, they "follow the forms" provided by the State, hoping that the liability so determined might somehow approximate the correct tax. It is principally because some such pragmatists and empiricists have had a number of rude awakenings that the Committee believed it appropriate to cull from the law and regulations those concepts which have especial bearing on the New York State income tax liability of decedents, estates and trusts. A study in comparative tax structure (i.e., federal vs. state) is not here contemplated; instead, I shall merely point up some special situations for your consideration. The presentation will consider the following general areas:

- Problems in the preparation of the final return for a decedent.
- Problems in the preparation of the returns for an estate and the beneficiaries thereof.
- Problems in the preparation of the returns for a testamentary trust and the beneficiaries thereof.

Abraham J. Briloff, C.P.A., is a member of our Society and of the American Institute of Accountants. He is a member of our Society's Committee on New York State Taxation and a former chairman of its Committee on Fiduciary Accounting.

Mr. Briloff is engaged in the public practice of accountancy on his own account. He is also a Lecturer on Accountancy at the Bernard M. Baruch School of Business and Public Administration of The City College of New York.

This article is based in large measure upon a paper presented by Mr. Briloff before a technical meeting of the Society's Committee on New York State Taxation, held in November, 1955. Other papers of his have previously appeared in this publication, the *Journal of Taxation*, and the *Commodity Year Book (1955)*.

The Decedent's Final Return

Accrued Income: In this connection, it is to be remembered that the New York law, in the first instance, requires that the decedent's final return shall include all income and gains which had *accrued* up to the date of death, regardless of the method of reporting income previously utilized by the decedent. Thus, even where the taxpayer is on the cash basis, the final return for the decedent is to be prepared on the accrual basis, *unless* certain conditions precedent are met. These conditions include the filing of agreements by all persons entitled to receive the accrued, but uncollected, income whereby they undertake to include such income in their returns when received, as well as the filing of a bond to secure the payment of such ultimate tax. It follows that where the agreements and bonds were not filed, the presumption is that the accrual method was used in the preparation of the final return for the decedent.

A problem arises as to what is required to be done where income collected some years after death, is determined to have accrued prior to death but was *not* included in the decedent's final return, and where the recipient had *not* filed the bonds and agreements referred to above. *Query*: Is the recipient of income under such circumstances required to include this income in his return when received?

To be specific: Consider a situation involving the collection, some ten years after death, of the proceeds from the sale of a patent where the sale of the patent had been effected by the decedent-inventor during his lifetime. If it be assumed that the gain in question had accrued at the time of death, then the income should have been taxed in the decedent's final return. Yet, suppose it had not been so accrued and there were no agreements and bonds filed; — is there then any basis for subjecting this income to tax to anyone? Assume, of course, that the period within which a deficiency might have been asserted with respect to the decedent's final return has expired? Further in this connection, since the sale of the property here involved was effected by the *decedent* prior to his death, the mere collection of the proceeds from sale would not appear to represent a capital gain from the sale or exchange of property by the *estate* (or its *beneficiaries*).

Similarly, the death of a decedent owning instalment obligations presumptively gives rise to the acceleration of the taxation of the income which had been previously deferred. This presumption may similarly be overcome by the filing of the agreements and bonds referred to previously. The dilemma heretofore discussed, leading to the possibility of "tax to no one", might be applicable here also if the deferred income were not accelerated in the final return and the bonds and agreements were not submitted.

Joint Returns: Section F of the instructions accompanying form IT 205, (the Fiduciary Return) in discussing the return for the decedent states (with emphasis in the original):

> A JOINT RETURN OF INCOME FOR THE DECEDENT AND THE SURVIVING SPOUSE FOR THE TAXABLE YEAR IN WHICH FALLS THE DATE OF DEATH OF THE DECEDENT IS NOT PERMITTED.

I suppose the foregoing categoric prohibition is somewhat overly generalized. Presumably, in the rare cases where, death notwithstanding, the taxable year of both spouses ends on the same day (e.g., death on December 31, or the simultaneous death of both spouses) the joint return would still be permitted.

By virtue of this ban against joint returns, any deductions or exemptions of the surviving spouse (other than the proportionate part of the $2,500 marital exemption) may not be applied to the reduction of the decedent's net income for his final tax year. Further, by reason of the limits provided by Section 360 of the Tax Law, the deduction for medical expenses is limited to $750,—the maximum amount deductible in a separate return.

Recently, I had occasion to correspond with the State Tax Commission outlining the apparent inequities which flow from the compulsory filing of separate returns in the year of death. I indicated that this inequity appeared to bear most heavily on our lower-income taxpayers, inasmuch as their more prosperous brethren would probably prefer to file separate returns anyway. The plea was rejected by the Commission principally because there was no provision in law whereby the joint return could be allowed where death causes the spouses to have different taxable years.

Exemptions: Regarding the exemptions allowed on the final return, the law requires an apportionment predicated on the number of months of the taxable year that the taxpayer qualified for a particular status. The apportioned exemption attributable to the marital period (i.e., of the $2,500 exemption) may be divided between the decedent and the surviving spouse in any manner desired. Over and above the exemptions thus determined, there is also allowed a further exemption equal to the proportionate part of a single exemption of $1,000 for the period from the date of death to the end of the decedent's normal taxable year.

Residence Status in Year of Death: The Tax Law (Section 350, subdivision 7) provides that where a person has a permanent place of abode within New York and who spends in the aggregate more than 183 days of the taxable year within the state, such person shall be deemed to be a resident for income tax purposes *even though he is domiciled outside of the state.* It is significant that the 183-day standard is absolute, even though the death of a taxpayer may foreshorten his taxable year. Thus, a taxpayer *domiciled without the State* who dies in June or earlier of a calendar taxable year, would be deemed to be a non-resident for income tax purposes, even though he had a place of abode within the State and resided within the State each day up to the time of his death. This, despite the fact that for many years prior to his death the taxpayer was required to file resident returns under the 183-day rule.

The Decedent's Estate

Resident vs. Non-Resident Estates: Estates are classified into two categories —resident and non-resident. The former includes the estates of deceased persons who, at the time of their death, were domiciled within the State. The latter takes in the estates of all other decedents. Thus, the location of the assets or the residence of the fiduciary are not significant factors.

In so far as non-resident estates (and trusts) are concerned, their income is taxable only if and to the extent that it is derived from property owned or from business carried on within the State of New York, and then only to the extent that it is not properly paid or credited to the beneficiaries thereof.

A resident estate is subjected to tax on its income on a basis consistent with that applicable to individuals residing within the state, with the following special provisions:

1. Income paid or held for charitable and similar purposes may be deducted without limitation, if thus paid or held in accordance with the provisions of the decedent's will.

2. Expenses of administering the estate (legal fees, executors' commissions, custodial expenses, etc.) are deductible (to the extent not applicable to tax-exempt income) providing that where such expenses may be deductible for estate tax purposes, the fiduciary files a Form F 15 (in duplicate) with the income tax return for the estate. This form is the statement required by Section 365, subdivision 9, of the Tax Law whereby the fiduciary asserts that the expenses referred to have not been claimed or allowed under paragraph 1 of Section 249-s of the Tax Law in the Estate Tax return of the subject estate, for purposes of the Estate Tax imposed by Article 10-C of such law, and waives the right to have such items allowed at any time as deductions under such paragraph. Presumably a statement in lieu of such Form F 15 would suffice as an affirmation that these expenses had not been claimed under both the estate and income articles of the Tax Law.

3. The estate is also allowed a deduction for any income properly paid

or credited during the taxable year to any legatee, heir or other beneficiary.

4. The optional deduction is not available to an estate.

5. An exemption of $1,000 is allowed to the estate. This exemption is prorated for taxable years of less than twelve months.

Rates of Tax: The tax rates applicable to the net income thus determined are the same as those applied to individual taxpayers; similarly, the credits against the tax recently allowed to individuals are also available to estates.

Capital Gains: In so far as capital gains are concerned, the fiduciary is taxed on the *entire amount* thereof, excepting to the extent that such gains are paid or accumulated for charitable or similar purposes pursuant to the terms of the will and, of course, to the extent the aforementioned $1,000 exemption was not used to offset ordinary income. It is significant, then, that the capital gains are taxed to the estate as an *entity*, whereas ordinary income is taxed to the estate merely as a *conduit*. In essence, then, capital gains are taxed to the estate regardless of whether they have been distributed to those ultimately entitled thereto, whereas ordinary income is taxed to the estate only if it remains with the fiduciary.

Basis: The basis of property acquired from the decedent is the value thereof on the date of death — the optional values provided by the federal Code are not here applicable.

Taxable Year: The fiduciary may adopt the calendar year or fiscal year basis for the reporting of income.

Tax Planning Hints: Below are some observations with respect to planning the administration of an estate in order to effect the maximum economies in New York State tax. The reader is cautioned to consider the possibly conflicting effects of federal taxation on any decisions which might be thus taken:

1. It is immaterial that all, or a portion, of the income is being held for distribution to a non-resident beneficiary who, if the income were distributed to him, might not be subject to taxation on such types of income; if the income had *not in fact* been paid or credited during the year, the fiduciary is taxable thereon. It would follow that, excepting for rents and so-called other income from New York sources, the fiduciary should consider the prompt payment or crediting of income to non-resident beneficiaries.

2. Inasmuch as *all* capital gains realized by the fiduciary (whether credited, distributed, distributable or paid out) are nevertheless taxed to the estate entity, it would appear to be appropriate for the fiduciary to distribute to non-residents *in kind*, their portions of assets which may have appreciated in value, and not to effect a sale thereof with resultant taxable gain. In this way the non-resident can (in most instances) avoid the burden of having to participate in a capital gains tax.

3. With regard to the realization of capital gains, the fiduciary is deemed to have realized capital gain where he effects the distribution of appreciated property in settlement of a legacy of a fixed amount. Thus, where property with a basis of $8,000 is distributed in satisfaction of a legacy of $10,000, the fiduciary is deemed to have realized a gain of $2,000. This might raise problems where the legacy to a surviving spouse is stated pursuant to some so-called marital deduction formula such as, say, "an *amount equal* to one-half of my net estate as determined for estate tax purposes, etc., etc." It is conceivable that any distribution in kind of appreciated assets might give rise to gain taxable to the fiduciary.

In this connection, the Commissioner of Internal Revenue in his recently promulgated Rev. Rul. 56-270, I.R.B. 1956-25, 22, determined that where a decedent bequeathed in trust for the benefit of his wife an amount sufficient to utilize the marital deduction to the maximum extent authorized by the Code, then the marital trust fund became a bequest of a fixed and definite "dollar amount". Accordingly, capital gain (or loss) was realized to the extent that the fair market value of the property on the date of distribution to the trustee exceeded (or was less than) the basis of such property in the hands of the executor.

Generally, however, where the fiduciary effects a distribution in kind to the residuary or specific legatees, there is no taxable gain or loss deemed to have been realized by the fiduciary.

The Beneficiaries of the Estate

The measure of taxation of the beneficiary is, generally, the amount of the estate's taxable income which was paid or properly credited to the beneficiary, as shown by the fiduciary's income tax return. Thus, a beneficiary is not subjected to tax on any capital gains which may have been distributed to him; nor is he subjected to tax on any distributions deemed to be from the corpus of the estate nor from the portion of the distribution stemming from exempt sources.

Section 365 (4) of the Tax Law states the following rule with respect to the taxable year for reporting income derived from the estate:

> "Any amount deducted . . . [as distributions] . . . in computing the net income of the estate or trust for the taxable year shall be included in computing the net income of the beneficiary for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending within the fiscal or calendar year upon the basis of which such beneficiary's net income is computed."

Thus, if the estate and the beneficiary are both on the calendar-year basis then the estate's distribution deduction for the year ended December 31, 1955, is reflected in the beneficiary's 1955 return. However, if the fiduciary has adopted a taxable year ending on October 31, then the estate's distribution deduction for its year ended October 31, 1955, is reflected in the beneficiary's 1955 return; the estate's distribution deduction for its year ended October 31, 1956, is to be reflected in the beneficiary's 1956 return.

Further, as had been indicated above, a non-resident beneficiary is taxable only on such part of his income (other than capital gains or capital losses) from the estate as arises within the State of New York (exclusive of annuities, interest, or dividends, except to the extent which such interest, etc., shall be a part of the income from the business, profession or occupation carried on in the state, subject to taxation). Where a business, profession or occupation is carried on both within and without the state, a non-resident beneficiary is subjected to tax only on the portion of the income of such business apportioned to the State. Where a fiduciary is carrying on business both within and without the state, and where the estate has a non-resident beneficiary, the fiduciary is required to file a form 205-A which has, as its objective, the determination of the proper measure of tax of the non-resident beneficiary.

Testamentary Trusts and the Beneficiaries Thereof

The concepts of state taxation discussed above for decedent's estates and the beneficiaries thereof are, generally speaking, also applicable to the trustee

of a testamentary trust and its beneficiaries, excepting that the trustee may deduct (and the beneficiary shall report) income of the trust which is currently distributable, regardless of whether such income had been paid or credited during the taxable year.

It is significant that the income beneficiary is taxable on the entire amount of the income thus distributed or distributable to him, even though such amount exceeds the entire income of the trust. This is so because there may be a net corpus deduction or other special conditions prevailing in the trust (e.g., mortgage salvage operations) which permits the income beneficiary to receive more by way of income than the entire amount of taxable income of the trust. (*Note:* The 1954 Internal Revenue Code eliminated this incongruity for federal tax purposes.)

Under the Regulations, Article 182 (predicated on Tax Law, Section 360(8)), the deduction for depreciation

"... is to be apportioned between the income beneficiaries and the trustees in accordance with the pertinent provisions of the will, deed or other instrument creating the trust, or in the absence of such provisions, on the basis of the trust income which is allocable to the trustees and beneficiaries respectively."

Further, the concepts discussed previously with respect to estates and their beneficiaries relating to: their classification into resident and non-resident categories, the deductibility of charitable distributions and accumulations, the deduction for expenses of administration, the specific exemption, the taxation of capital gains to the fiduciary in their entirety, basis of property, taxable year problems, and the taxation of non-resident beneficiaries, are also applicable to the taxation of trusts and their beneficiaries.

By way of conclusion, the reader's attention is directed to the frame of reference set for this paper at the outset. Thus, I have sought to cull from the Tax Law and Regulations only those provisions which have especial significance to decedents' final returns, their estates, and trusts and the beneficiaries thereof—all in the hope of helping us to avoid some of the booby-traps which are bestrewn over our course.

What's New in New York State Income Taxation

(Continued from page 601)

come and deductible by the husband, in the absence of a joint return.

Officers Who May Verify or Certify Returns Under Article 9, 9A, 9B and 9C

Effective July 1, 1956, any duly authorized officer may sign a corporate return and a signature is prima facie evidence that the individual has authority to sign the report. (Tax Law, Sec. 194, as amended.)

War Losses

Starting April 5, 1956, the treatment of war losses for personal income tax purposes will be the same as under the provisions of the United States Internal Revenue Code. (Tax Law, new Sec. 358-b.)

Deductions of Non-Residents

A New Jersey resident attempted to deduct real estate taxes on his home in New Jersey as well as interest on a mortgage thereon, medical expenses in excess of 5% of his net income, and a $150 life insurance premium. The court in reviewing a determination of the State Tax Commission decided in its favor (*Goodwin* v. *State Tax Comm.*; App. Div., Third Dept.; 11/16/55) and held that Tax Law, Sec. 360.11, is constitutional and that the provision which allows non-resident deductions "only if, and to the extent that they are connected with income arising from sources within the state and taxable under this article to a non-resident taxpayer" is valid and not discriminatory against non-residents.

Learning to Write

By A. C. LITTLETON, C.P.A.

The accounting profession has long been aware of the usefulness in an accounting career of the ability to write well. In this paper, Professor Littleton indicates how accounting practitioners, educators, junior staff men and students may help in the attainment of this goal.

As every schoolboy knows, learning to write is not easy. Usually he is already convinced there are many other things more interesting than struggling to learn to form letters and to chain letters into words. He probably would not believe it if told that writing can become as fluent as speech; he surely would be hard to convince that his future could be strongly influenced by a laboriously acquired ability to build ideas into sentences and sentences into paragraphs.

Perforce the student is kept in contact with exercises in written expression as long as he is in school. And his antagonism may persist, beneath a minimum of passing work, throughout college and into some career. On the other hand, many students gradually come to perceive the elements which make for good writing; and perhaps even feel a sense of pleasure in practicing the art of effective composition. This is most likely to happen if wise teachers have brought him to see the architectural features of English composition—the planned sequence of paragraphs, each contributing relevant content and visibly showing textual interrelations which give continuity of theme and unity of structure.

A. C. LITTLETON, PH.D., C.P.A., is Professor (Emeritus) of Accounting, University of Illinois, residing in Denver, Colorado.

He is the author of "Structure of Accounting Theory" and co-author of "Introduction to Corporate Accounting Standards", and has written extensively in the fields of accounting theory and history.

Dr. Littleton is a member of the American Institute of Accountants and is a past president of the American Accounting Association and former Editor of *The Accounting Review.*

Role of the Accounting Practitioners

What of those students who have not had inspiring teachers, or have been able to sidestep available courses in writing? Some of these may have been accounting majors. Can the accounting profession do anything to help staff men toward self-development in writing ability, or to help teachers and students still in college, to realize more strongly the usefulness in an accounting career of an ability to write well?

Acceptance of Improvement in Accounting Education

Public accountants some years ago were slow to believe college graduates would make desirable staff members. But developments in the techniques of accounting education in the collegiate schools of business have overcome those

beliefs; and perhaps have contributed not a little to the ability to write effectively about accounting which has for some time been reflected in the literature.

The improved quality of accounting literature could be made an objective lesson for students by their college teachers, and an indication that accountants do write, and well. More and more the colleges, following the lead of the profession in recognizing communications as basic, will succeed in improving their efforts to help accounting majors to sense the need to prepare themselves in that direction. But the responsibility should not be considered that of teachers' alone.

Needed Modifications in the CPA Examination

Has the CPA examination provided any stimulus to better written expression? For a long time the questions have reflected what seemed an intangible consensus that accounting theory could not be expected to provide satisfactory examination material; that the grading of "essay type" questions was quite impractical for a professional test. If ability to write clearly is professionally important, it would seem that the most conspicuous place to make that point would be somewhere in the professional examination. The reinstatement of a paper on accounting theory in the national examination is undoubtedly a step in the right direction, especially since, in recent years, some questions open the doors to written composition by asking "why", by requiring "justifications", by making necessary a reasoned choice between alternatives.

But is this enough pressure toward developing writing ability? Other changes could be introduced which, besides adding more encouragement to practicing the arts of good writing, could conceivably raise the stature of the examination as a testing of the candidate's fitness to take a stand as a professional man.

Important and beneficial changes, in addition to the theory paper, have been made. Notably in the collection of question materials, the choice of the material used, the statement and timing of questions and problems, the grading supervision, the conditional examination, etc.

It would in my opinion be a further beneficial change to make much less use of problems about consolidated statements. There was a time some years ago when installment liquidation of partnerships seemed to be strongly relied upon "to separate the men from the boys." May it not be possible that, without conscious intent, consolidated statements have inherited some of that "function"? How long is it before a typical successful candidate meets a consolidated statement face to face in the field, even as a senior accountant? How long is it before he has had to deal with his first ten? Are such problems, in the extent they are found in the examinations and text books, indicative of their relative importance in average professional experience? If they serve primarily to test an ability to marshall complex data intelligently, are there no other problem materials adequate to that purpose? Should texts and classroom work approximate coaching in the marshalling of data, or should data marshalling be made an instrument for training students to think? If the latter purpose prevails, why are consolidated statements so superior as to be given greatest prominence?

In fact, it might well produce a more professional testing procedure if the

amount of other problem solving were also reduced so that time would be made available for two papers in auditing—surely the heart of professional practice—and for an expanded theory test—where reasoning rather than remembering was stressed.

There are of course objections. An early hesitance about objective grading of "essay" answers is one of them. Yet it would seem that this point could be met by a clearly announced policy—that of grading factual material objectively and quantitatively, and that of separate, qualitative grading for effective writing in the auditing and theory papers or designated questions therein. Literal grades could be used to express a judgment regarding quality. A value of B (satisfactory) would bring no change in the arithmetic evaluation of technical correctness; a value of A would raise the grade an announced number of points, a value of C would reduce the arithmetical grade an announced number of points.

Such qualitative judgments are not difficult to make; they are used regulargely in many colleges. And of course they would be reviewed for consistency. A low amount of adjustment for effective and for ineffective writing would at most be a small penalty or premium, yet enough, when reported to the candidates, to prod the one to more effort and commend the other on a point of significance to a professional man.

Recognition of Value of Thesis and Formal Instruction in Writing

Other efforts in the profession could also encourage work at improving writing ability. If it were made known that an accepted master's thesis would influence starting salary more than the degree without thesis, this kind of exercise in written expression would become part of the program at more universities. The college record of prospective staff men could provide a clue to the individual's interest in learning to write. The number of writing courses taken and the grades earned could be commented on at the time of the recruiting interview, and their significance indicated.

Desirability of Writing for Firm Publications

Men on the staff could be steadily urged to practice at writing up observations from their field experience and the results of related collateral reading. If the firm publishes a periodical, the best items submitted could be printed there. If no such publication has been established, it might prove a good investment to start one in a simple form. Not only would staff men be thus encouraged to practice writing, the staff generally could also benefit. Reading about unfamiliar aspects of accounting can be almost as broadening as direct experience.

Role of the Accounting Educators

University administrators are fully aware of the broad usefulness of a well-developed ability in written expression. But they also realize that even required courses in writing can only provide opportunities for students to practice that skill. Anything men in the profession can do to convince students the profession at large considers the art of written expression an aid to advancement, will be appreciated in the colleges. It might well be that many students would trade some of the grind on consolidated statements for some stimulating exercise in learning to write better.

College teachers can urge students to take classes, but the benefits gained

by being present cannot be made uniform by the teacher's exertion. For that reason a multiplication of courses may not alone suffice. The profession should strive to provide teachers with evidence which will help stir students to make the effort in class which is necessary if they are to learn to write effectively.

Provision for More Writing Practice in the Curriculum

There are several things the collegiate schools of business could do. They could consider where the program could be adjusted to make room for more writing practice. If accounting majors are not now required to take some work in verbal expression each undergraduate year, such a requirement should be put under consideration. Freshmen themes and business letters are usually offered. A semester of public speaking could well be added and a year of English literature. The latter item is a more desirable requirement than a foreign language. The reason is that the student's writing vocabulary will be increased, his range of ideas will be broadened, and the analytical contact with good writing will improve his technical competence in effective writing. This last point is particularly important.

Introduction of a Course in Report Writing

It would also be helpful if a course were offered in report writing. This should not be audit reports but exposition based on short research projects—a sort of course in theme writing for fourth-year students. It should not be difficult to introduce some writing of papers in several of the usual accounting courses. And it could be made current practice to announce that good or poor expression in textual matter in short quizzes and longer examinations will influence the grade. Every candidate for a master's degree should be required to write an acceptable thesis; the depth of the research would be of less importance than the quality of the writing. It may seem easier for student and faculty to permit substitution of another text-problem course, but the educational benefit to the student is far from comparable.

Proper Articulation of General and Professional Education

Most of the important aspects of a "liberal education," one of which is practice in writing, can be associated with technical work in business administration and accounting. The universities which compose the Association of Collegiate Schools of Business have for a long time been very effectively combining these two aspects of education, many of them choosing to articulate general and technical education throughout four years. If work to the bachelor degree is stratified between the first two years and the last two, the effect is to introduce a too-strong feeling among upper division students for a high degree of specialization. It seems reasonable that an approach to business technicalities could with advantage to the student in a collegiate school of business be given in the early years; and it would clearly be beneficial to such students to study some of the important parts of general education in their maturer years as upper classmen.

The administrative problems of curriculum modification are complex. This is part of the reason the profession should try to make it unmistakable that ability in written expression is a necessary aspect of a career in public accounting. It is evident in the current

literature that many accountants write well; this is itself an indication that recruits should learn to write well. It may well be that the time has come somehow to make visibly desirable the capacity to use the English language effectively. I must say again, the best way I can think of is direct association of good writing with the CPA examination. The stimulus thus provided could be expected to influence university instruction, to induce college students to work at the problem, and to inspire staff men to develop projects in self improvement with encouragement and help from their firm.

Role of the Accounting Student and Staff Juniors

In this day, when "do-it-yourself" is so much in the advertisements, it is not unreasonable to hope some of that spirit may infect college students and younger staff men if the idea is put before them. Teachers could encourage students to take on some do-it-yourself attitude in this matter of practice writing and practice critical re-writing. All of their education does not have to carry graduation credit. Being editor of the school paper does not. Moreover, it could strengthen the individual to have learned to accomplish something worth while on his own, without pressure from classroom assignments, or prodding from short quizzes.

Staff men could be encouraged to set themselves to the task of improving their prospects by teaching themselves to write more effectively. After all, most of the educative process has to function within the individual. Probably the most important thing a student learns in college is how to go about learning. It is not necessary to attend night classes in writing. There are many things in accountancy to write about. And they can be taken in hand privately, in small doses at first. Practice makes for perfection—practice and analytical study of examples of good writing. Once you have a reasonable mastery of the art, writing is fun, and there need be no end to the fun.

Franchise Tax Savings Opportunities

(Continued from page 598)

If such an inequity results, it may be best that the federal adjustments resulting from consolidation not be made on the separate state return but that full disclosure be made. The state will undoubtedly question the departure from the regulations, but there is a reasonable chance of equitable settlement being made with the state authorities.

New York State Tax Forum

Conducted by Benjamin Harrow, C.P.A.

Domicile as a Basis of Jurisdiction to Tax . . . Exemptions from Estate Tax . . . Sales and Use Taxes—Revised Resale Certificates.

Domicile as a Basis of Jurisdiction to Tax

The New York State income tax law taxes every resident on his income from all sources and every nonresident on income only from New York sources. It is possible for one to be taxed as a resident even though he has no home in New York and does not reside in New York. That is true of an individual who is domiciled in the state. The terms domicile and residence are commonly used interchangeably. Domicile is a legal relationship of an individual to a state. Every individual starts with a domicile of origin, generally the domicile of the father. This domicile continues until it is changed and a change is accomplished through an intent to change plus a physical presence in a new home.

Benjamin Harrow, C.P.A., has been a member of our Society since 1928, and a member of the American Institute of Accountants since 1922. He is a member of the New York Bar and Professor of Law at St. John's University.

Mr. Harrow is a past Vice-President of the Society. He is a past Chairman of the Committee on Publications and of the Committee on State Taxation. He is also a member of the Institute's Committee on Federal Taxation.

Mr. Harrow is engaged in practice as a certified public accountant and attorney in his own office in New York City.

A recent case[1] highlights the distinction between domicile and residence. In this case the parents of some infants had died. The Surrogate had appointed a resident of California as guardian of the person of each infant. The plaintiff bank was appointed general guardian of the property of the infants. At the time of the parents' death the infants resided and were domiciled in New York. The guardians of the persons took the infants to California where they actually reside. The income of the children is derived from New York sources. The bank voluntarily had filed California income tax returns for the children.

The bank argued that the infants were not domiciled in New York and hence were not taxable on the income. To this the court replied that as infants they were legally incapable of changing their domicile of origin. Their guardians could not change the infants' domicile, since they were neither natural guardians nor testamentary guardians. This is so even though their actual residence was changed.

There is an exception in the law to the rule that a resident includes any person domiciled in the state. That exception applies to a person who maintains no permanent place of abode within the state but does maintain such a home without the state and who spends in the aggregate not more than 30 days of the taxable year within the state. When this point was argued the court said that to maintain a place of abode requires the exercise, volition or choice

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[1] First Trust & Deposit Co., as general guardian of the Property of Huntington B. Crouse, III, v. Goodrich (N. Y. Sup. Ct., A. D. 3rd Dept.; July 9, 1953).

Accounting at the S. E. C.

Conducted by Louis H. Rappaport, C.P.A.

When financial statements are prepared for filing with the SEC there must be a disclosure of any change in accounting principle or practice, made during any period for which the statements are filed, which affects the comparability of such statements with those of prior or future periods. There must also be a disclosure of the effect upon net income of the period in which the change occurs (Rule 3.07(a) of Regulation S-X). Another rule of the SEC relating to accountants' certificates requires the accountant to state clearly his opinion regarding these changes in accounting principles or practices (Rule 2.02(c) of Regulation S-X).

The conventional short form of accountants' report contains a scope paragraph and an opinion paragraph. In the opinion paragraph the accountant reports (1) whether the financial statements present fairly the company's position and results of operations in conformity with generally accepted accounting principles, and (2) whether such accounting principles have been consistently applied. Where there has been a change in accounting principles or practice, the accountant, pursuant to Rule 2.02 referred to above, states his opinion concerning the change, frequently in language somewhat along the lines of the following:

> In our opinion, the accompanying financial statements present fairly the financial position of (name of company) at (date) and the results of its operations for the (period) in conformity with generally accepted accounting principles applied on a consistent basis, except as to the change in (accounting principle or practice) referred to in Note .., in which change we concur.

It has seemed to many accountants that the specific provision in Rule 2.02(c) is unnecessary. Where there has been a change in accounting principle which the accountant could not approve, it would seem that his disapproval would also apply to the fairness of the presentation in the financial statements. It is difficult to conceive of a case where the accountant would disapprove of a change in principle and yet approve the fairness of the presentation of the financial statements. It would seem to follow then that if the accountant is in a position to give an affirmative blessing to the financial statements as being in accordance with generally accepted principles of accounting, it is unnecessary and superfluous for him to state specifically his opinion of the change in principle or practice.

Accountants have grumbled for some time about the provision in SEC's Rule 2.02(c) and it is refreshing to note that at least one accounting firm has taken the bit in its teeth and in its report has omitted to state specifically its opinion concerning a change in the client's accounting principles. The accountant's report in question appears in a final prospectus which went through the SEC registration process.

The company in question made changes in its accounting for depreciation and sales of common stock to employees. A note to the financial statements discloses the adoption for ac-

Louis H. Rappaport, C.P.A., a partner in the firm of Lybrand, Ross Bros. & Montgomery, C.P.As., is the author of *SEC Accounting Practice and Procedure.*

counting as well as tax purposes of the "declining balance" method of computing depreciation, whereas the company previously had followed straight-line depreciation. Also, the company in prior years had offered stock to its employees with the option of payment on an installment basis. In most instances the quoted market value on dates of delivery of stock sold under such offerings exceeded the selling price and the excess was charged against income and credited to capital surplus. In the most recent fiscal year the company changed its practice in this respect and no longer charges income for the excess of market value over the subscription price at the time of delivery of the shares subscribed for. The company disclosed the effect of this change in accounting policy.

Notwithstanding the changes in accounting principles referred to above, the last paragraph of the report of the certifying accountants is as follows:

> In our opinion, the (financial statements) present fairly the financial position of the companies at (date) and the results of their operations for the three years then ended, and the summary of earnings summarizes fairly the results of operations for the ten years ended (date), all in conformity with generally accepted accounting principles applied (except for the changes in the method of providing for depreciation and in accounting for sales of common stock to employees explained in notes .... and .... to the financial statements) on a consistent basis.

Apparently no exception was taken by the SEC to the accountant's report because, as indicated above, this is the form of the accountant's report as it appears in the final offering prospectus.

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and this the infants did not possess. It was also noted that the Surrogate in appointing a guardian of the person retained continuing jurisdiction by designating the clerk of his court as a person upon whom process on the guardian might be made if they could not be found within the state.

Exemption from Estate Tax

Section 200 of the Surrogate's Court Act provides that a surviving spouse is entitled to household equipment and utensils to the amount of $1,000 and, also, cash to the amount of $1,000. This section provides further that such items to which a widow is entitled are not deemed assets of the estate and are exempt from the estate tax. This issue came before the Surrogate Court of Cattaraugus County on February 13, 1956.[2]

Sales and Use Taxes—Revised Resale Certificates

With respect to transactions on and after June 1, 1956, vendors are required to obtain resale certificates from their customers on a new form prescribed under Sales Tax regulations promulgated January 5, 1956.

[2] Estate of Andrew J. Forness.

Office and Staff Management

A forum for the exchange of views and information on all aspects of the administration of an accounting practice.

Conducted by MAX BLOCK, C.P.A.

Confidential Nature of Accountants' Work Papers . . . Staff Members' Clients . . . Oral and Written Communication in the Profession.

Confidential Nature of Accountants' Work Papers

On prior occasions there have been reported in this column cases upholding the contention that accountants' work papers are not privileged, in the eyes of New York law and for federal income tax purposes, as are an attorney's files. There were even doubts as to whether an accountant's papers in the possession of the client or his attorney were privileged.

A recent Federal District Court decision *(In the Matter of the Application of J. M. House to Enforce Obedience to the Requirements of a Summons Served upon Czar Smith Winters* U. S. Dist. Ct. No. Dist. Calif., So. Div., Misc. No. 421 7/11/56) held that an accountants' working papers which had been turned over to the client and his attorney as agent, by request, were privileged and did not have to be surrendered in compliance with a subpoena. This decision has all the earmarks of a drawn out legal struggle and should therefore not be considered the last word.

In the instant case the Treasury Department was building up a fraud case leading towards possible indictment and the accountant's files evidently were believed to be important for this purpose.

MAX BLOCK, C.P.A. (N. Y., Pa.) is a former chairman of the Committee on Administration of Accountant's Practice of the New York State Society of Certified Public Accountants. He is a lecturer at The City College of New York in the graduate course on Accounting Practice. Mr. Block is a member of the firm of Anchin, Block & Anchin.

Staff Members' Clients

Should an accounting firm encourage or discourage staff members to bring in clients that they are able to obtain, to be handled by the firm? How, if at all, should they be compensated? What control should be exercised by the staff members over such clients? These, and related questions, arise from time to time in many an accounting office. No general over-all attitude is known to exist. The answers vary on the basis of size of the accounting firm, the standards of the practitioners, and even on the basis of personalities.

A recent survey of four of the larger of the medium-sized accounting firms, and inquiries as to prevailing practices disclosed uniformity in certain respects, yet a great deal of diversity on a profession-wide basis.

Here are some of the facts so ascertained. Though the sampling was very small the conclusions appear to the writer to have fairly widespread application.

As to encouraging or discouraging staff men from bringing clients to their employer, this appears to be the picture: Staff members of large national firms are rarely in a position to obtain clients suitable to their employers and the problem is virtually non-existent there. The medium-sized firms do not encourage the practice but will, in limited respects, handle clients brought in by staff men largely as a friendly gesture to these

men. Some firms would rather have the clients brought to them than encourage private night-time and week-end practices. A few, and very few, will give men time off, say one or two days a month, to handle private clients. This practice is subject to serious criticism in that it encourages private practices and can undermine the efficiency and morale of a staff. Even if it is limited to one or two veteran staff members, it is a discriminatory and otherwise unsound policy. Smaller firms are usually more receptive to obtaining clients from this source because of the greater urgency for building up clientele and income.

With respect to control of the clients, some firms integrate them fully into their practice to the extent that different staff men are assigned. Others will permit the man who has initiated a client to handle it, though under their control. In most cases men are given to understand that "their" clients will be released to them if they leave to go into public practice on their own account, but in some a release is not automatically given. This is not as simple a matter as it may appear on the surface because a small client brought in by a staff man may, in time, become substantial and have offshoots. Some part of the growth and the development of offshoots may be attributable to the accounting firm rather than the staff man. How would that be divided up? It is very rare, it appears, that clients obtained through staff men are material in respect to size and fees and in numbers.

As to compensation, considerable diversity prevails. Even within one firm the arrangements are not necessarily uniform. One firm, having only one client so obtained, paid annually an amount equal to 10% of the gross fee. Another paid either one third of the gross fee or one half of it net fee (gross fee re payroll cost), whichever lesser. One firm reported that it permitted a staff man, an old, faithful employee, to keep all of the fee from one client. This practice may perhaps be reflected, somehow, in the annual wage or bonus payments. One practitioner advised that a salary increase, equivalent to 20% of the clients' fee, was paid.

Practitioners who have had experiences with this aspect of staff relations are requested to communicate them to the Editor of this column for consideration and possible publication.

Oral and Written Communication in the Profession

An urgent need in the accounting profession, as in other professions, is for improvement in the arts of oral and written communication. This shortcoming has not been unrecognized, but it has recently been spotlighted for corrective action in the report of the Commission on Standards of Education and Experience for Certified Public Accountants. This is what the report states on the subject, in the discussion of the curriculum of the academic program for accountants:

> "Oral and written communication. The usual undergraduate curriculum offers the college student insufficient opportunity to develop his abilities in oral and written communication, one of the most important areas of training for a C.P.A." (P. 131).

The Commission recommends that this area of study be included in curricula. Where already included, or to be added, the implication is that it be adequate to bring about the required improvement in standards.

Payroll Tax Notes

Conducted by SAMUEL S. RESS

The New Social Security Law: Coverage Extended—More Professionals Subject to Self-Employment Tax . . . New Law Affects Fiscal-Year Reporting of Newly-Covered Professionals Now . . . Osteopaths' Status Requires Clarification for Social Security Coverage . . . Instructions to Newly-Covered Clients . . . Time to Review Employee Welfare Programs . . . New York Disability Benefits Law: State Disability Benefits Increased in Duration and Amount . . . State Disability Coverage Extended to Certain Employees of Non-Profit Institutions . . . Non-Duplication of Disability Benefit Provisions Eased . . . Division of Employment Announces New Professional Employment Network Successful.

The New Social Security Law

Coverage Extended—More Professionals Subject to Self-Employment Tax

An estimated 250,000 professional men and women will be added to the "self-employment tax" rolls under the new legislation. Newly-covered self-employed professionals include lawyers, dentists, osteopaths, veterinarians, optometrists, naturopaths, and chiropractors. More farm workers, T.V.A. and Federal Home Loan Bank employees are also covered by the new law.

The newly covered self-employed persons are taxable on their self-employment income for all fiscal years ending after *December 31, 1955.* The only major class of professional self-employed persons not covered by the Social Security Law are Doctors of Medicine.

SAMUEL S. RESS, an Associate Member of our Society since 1936, is a member of the New York and Massachusetts Bar. He has specialized in the payroll tax field since the inception of this type of legislation in 1936. He is engaged in public practice in New York City as a consultant on payroll tax problems.

Dr. Ress is a member of the Society's Committee on New York State Taxation and Chairman of the Sub-Committee on Unemployment Insurance.

New Law Affects Fiscal-Year Reporting of Newly-Covered Professionals Now

Taxable years ending after 1955 are covered by the new amendment. There is no proration of parts of a year so far as the self-employment tax is concerned. If any part of the taxable year falls in 1956, the entire income for the year representing net earnings from self-employment is subject to tax at the rate of 3% for 1956. The rate of tax on self-employment net earnings for any fiscal year ending in 1957 will be advanced to 3⅜%. However, taxpayers reporting on a calendar-year basis will pay the tax at the rate of 3% of their calendar year 1956 self-employment income, when they file their returns on or before April 15, 1957.

Those taxpayers newly covered by the law, using fiscal years ending in the first part of 1956, who have already filed forms 1040 without Schedule C attached, will now have to file amended returns and submit Schedule C showing the self-employment tax liability.

An example of one who should immediately file an amended return would be that of a 64-year-old self-employed lawyer who filed his income tax return for the fiscal year ending February 29th, 1956, on May 15, 1956. At the time he filed his return his self-employment income was not subject to the tax. Because of the amendment to the law, he must amend his return and pay the 3% tax on the self-employment income

for the entire year ending February 29, 1956.

Osteopaths' Status Requires Clarification For Social Security Coverage

State laws vary considerably in the licensing of osteopaths. In those jurisdictions where they are considered as doctors, the Internal Revenue Service may provide the individual with an election not to be treated as a doctor for Social Security and self-employment tax purposes.

Instructions To Newly-Covered Clients

As was pointed out in the September, 1956, "Office and Staff Management" department of *The New York Certified Public Accountant* by Max Block, a bulletin to newly-covered clients from accountants should be sent out. It might well cover these seven important points of information:

1. Account Card and Number
2. Computation of Taxes Paid
3. Benefits, if Fully Insured
4. Benefits, if Currently Insured
5. Amounts of Old-Age and Survivors Insurance Benefits
6. Benefits, in the Event of Disability
7. Benefits for Women (working woman, wife of a retired beneficiary, widows, dependent mothers, widow with a disabled child in her care, etc.)

Time To Review Employee Welfare Programs

Accountants should make it a point to review their clients' employee-benefit welfare fund programs in the light of these new changes in the Social Security Law, in an effort to reduce presently mounting fringe benefit labor costs which will be directly felt by the rise in the Social Security rate from 4 percent to 4½ percent on January 1, 1957.

New York Disability Benefits Law

State Disability Benefits Increased In Duration and Amount

As distinguished from the permanent disability benefits for which provision has been made in the 1956 amendments to the Social Security law discussed above, the New York State Disability Benefits Law of 1949, which provides partial reimbursement to covered workers for loss of wages resulting from "*off the job*" sickness or disability, has also been amended effective July 1, 1956. The 1956 Legislature increased, from $33 to $40 a week, the maximum benefit that a covered worker may receive under the Disability Benefit Law.

The enactment also extended from 13 to 20 weeks the maximum period for which a worker may receive such benefits during any one period of sickness or disability.

State Disability Coverage Extended to Certain Employees of Non-Profit Institutions

Another measure extended coverage of the State Disability Benefit Law to employees of a non-profit organization who work in a profit-making commercial or industrial enterprise owned or operated by the non-profit organization. This enactment would cover an employee of a non-profit religious, charitable, scientific, literary, or educational organization, who worked exclusively in a commercial building entirely occupied by private rent-paying tenants and owned by the otherwise exempt organization.

Non-Duplication of Disability Benefit Provisions Eased

The Disability Benefits Law formerly provided that the amount of sickness benefits that a worker may receive shall be reduced by any amount he receives as a permanent disability pension under an employer or any governmental program (except under the veteran's disability program). The law has been amended with a provision that an employee's permanent disability pension shall not be offset against his benefits under the Disability Benefits Law if his claim for disability benefits is based on a disability other than the permanent disability for which the pension is being paid. This measure became effective July 1, 1956.

The battle of the "disability determinations" under the various recent enactments should be interesting in the not-too-distant future. The new Federal Social Security Disability Benefit Law, discussed earlier, specifically provides that the determination as to whether or not a claimant is so severely disabled as to qualify for the federal disability allowance must be made in accordance with the findings under the Social Security law. The fact that an individual may be receiving payments for "total disability" from another agency does not necessarily mean that he will be considered disabled under the provisions of the Social Security Law.

Division of Employment Announces New Professional Employment Network Successful

Many accounting firms in need of qualified personnel may not be aware of the new Professional Employment Network program of the State of New York Division of Employment. Commissioner Lubin informs us that the program provides a fast channel for placing professional personnel in jobs anywhere in New York, New Jersey, Pennsylvania, Connecticut, Massachusetts, Rhode Island, Vermont, New Hampshire, the District of Columbia, and Puerto Rico. The broadened placement service of the State was secured with the cooperation of the New York State Society of CPAs and other professional groups.

The following letter was received by Mr. Ress from Mr. Harry Zankel, Counsel to the Division of Employment of the New York State Department of Labor:

"The facts alleged by your colleague and reported in your August column are so wholly out of line with the unemployment insurance law and with our policy and practice that we can only conclude the story told you was, at the least, incomplete.

"If your informant is willing to identify himself and his client and make his complaint official, we will look into the facts. If the law or our policy have been violated, prompt corrective action will be taken. If he is not willing to have the facts checked, we can only conclude that he is taking advantage of you and your publication.

"As you are aware, any person having business with us has the right to be represented by anyone he chooses. And it is not possible that a claimant could be required to repay $180 unless the amount he had wrongfully collected was $180. We ask you, in fairness, to publish this comment."

Official Decisions and Releases

Accounting
TERMINOLOGY BULLETINS

August, 1956

No. 3

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Prepared by
Committee on Terminology
American Institute of Accountants
270 Madison Avenue, New York 16, N. Y.

Book Value

1. The term *book value* is one of several widely used expressions in which the word *value* appears with a particular qualifying adjective to denote a particular concept of value. *Book value* is to be distinguished from such terms as fair or market value or liquidating value, in that it refers to amounts reflected on accounting records and in financial statements.

2. The term *book value* is seldom if ever used in the body of financial statements, either as an indication of the basis of stating an item therein or in connection with owners' equities. To do so would involve a pointless truism and such use is therefore not recommended.

INDIVIDUAL ITEMS

3. In Accounting Terminology Bulletin No. 1, the term *value* is defined as follows:

> *Value* as used in accounts signifies the amount at which an item is stated, in accordance with the accounting principles related to that item. Using the word *value* in this sense, it may be said that balance-sheet values generally represent cost to the accounting unit or some modification thereof; but sometimes they are determined in other ways, as for instance on the basis of market values or cost of replacement, in which cases the basis should be indicated in financial statements.

4. This use of the word value does not involve the concept of current worth, but rather refers to a particular method of quantitative determination.

5. The following slight rephrasing of the first sentence of the definition quoted in paragraph 3 above gives the clue to the meaning which some have adopted for book value as applied to individual items in books of account or in financial statements:

> *Book value* signifies the amount at which an item is stated in accordance with the accounting principles related to the item.

6. Thus one might refer to the "book value" or "net book value" of fixed assets, or the "book value of investments." More specific terms, however, can

be used in describing the kind of value at which individual items are stated; as, for example, *cost less depreciation, lower of cost or current replacement cost,* or *lower of cost or selling price.* Similarly the term *ledger balance* or a term such as *the amount shown in published financial statements* would more clearly and accurately convey an exact meaning. The committee believes that any reference to a quantitative determination of a specific item can be more clearly and specifically described by terms other than the general and relatively vague term *book value.*

7. ***Recommendation:*** The committee recommends that the use of the term *book value* in referring to amounts at which individual items are stated in books of account or in financial statements, be avoided, and that, instead, the basis of amounts intended to apply to individual items be described specifically and precisely.

OWNERS' EQUITY

8. The committee recognizes that the term *book value* is also used in various business arrangements such as partnership agreements, contracts for sale of a business interest, and wills and trusts. For example, partnership agreements sometimes contain a provision that a deceased partner's interest may be acquired by surviving partners for an amount which is based at least in part on the "book value" of the interest. Contracts for the sale of going business concerns sometimes specify a price based on the "book value" of either the capital stock or the net assets. When used in such documents, the meaning to be ascribed to the term is a question of legal interpretation of the document and appears to depend primarily on the intent of the contracting or other parties rather than on any accounting definition of such term. While such uses of the term are common, they have given rise to misunderstandings and can easily develop into controversies when the intention of the parties is not clear. One typical difficulty arises when there is a change in circumstances between the time when an agreement regarding "book value" was reached and the time when that agreement must be interpreted. For example, a change from the Fifo to Lifo inventory basis between those two dates would affect the equities involved. Similar situations would arise with respect to any changes in accounting policies or from business combinations, divisive reorganizations, and other comparable events. Even in the absence of such changes, questions arise as to whether "book value" was intended to mean literally amounts shown on ledger accounts or amounts so shown after correction for (a) errors, (b) departures from consistently maintained practices of the enterprise, (c) departures from established practices of the type of organization, or (d) departures from generally accepted accounting principles, or any combination of such corrections.

9. When the intent of the parties is not clear as to the use of the term *book value* in reference to owners' equity, the committee suggests the following definition:

> *Book value* is the amount shown on accounting records or related financial statements at or as of the date when the determination is made, after adjustments necessary to reflect (1) corrections of errors, and (2) the application of accounting practices which have been consistently followed.

10. ***Recommendation:*** In view of the fact that the intent of the parties to arrangements involving sale or transfer of business interests should govern, and the foregoing definition may not reflect such intent, the committee recommends that the term *book value* be avoided. Instead of this term it is recommended that any agreement involving the general concept of book value should contain a clearly defined understanding in specific and detailed terms, particularly as to such matters as are referred to in paragraph 8 of this bulletin.

COMMITTEE ON TERMINOLOGY (1955-1956)

EDWARD B. WILCOX, Chairman
JOHN K. McCLARE
WILLIAM W. WERNTZ